



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	03/25/99	Bill Number:	AB 572
Tax:	Sales and Use, Special, and Property Taxes	Author:	Pescetti
Board Position:		Related Bills:	SB 1222 (Knight), AB 436 (McClintock), AB 1631 (1998) SB 1425 (1998), SB 1478 (1998)

BILL SUMMARY:

This bill contains provisions that would impact the Franchise Tax Board (FTB), the Board of Equalization (BOE), and the Employment Development Department (EDD). With regard to the BOE provisions, this bill would require the BOE, rather than the taxpayer, to have the burden of proof in any court proceeding with respect to any factual issue relevant to ascertaining the tax liability of a taxpayer, under certain circumstances. This bill would also require the Board to have the “burden of production” in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed.

ANALYSIS:

Current Law:

As a general rule, in civil cases involving the potential loss of money or property, the burden of proof is on the party in control of the facts. California law provides that taxpayers seeking relief, like plaintiffs in other civil actions, have the burden of proving that the government's action was incorrect and establishing the merits of their claims by a preponderance of the evidence. The burden of proof is placed on the taxpayer since that is the party who has control of the records and documents. It has been established in *Welch v. Helvering* (1933) 290 U.S. 111, 115 that the ruling of the taxing agency has the support of a presumption of correctness, with the taxpayer having the burden of proving it wrong. By contrast, in criminal cases involving the potential loss of liberty or even life, the burden of proof is on the government.

Under current Sales and Use Tax Law (and the other various tax and fee laws administered by the Board of Equalization), upon filing a return, a taxpayer may be requested to furnish additional substantiation of items reflected on their return, or as the result of an audit, be requested to pay additional taxes or be eligible for a refund. In a sales tax audit, for example, the auditor wants to determine the following about the returns that are filed: (1) Have all gross receipts from sales of tangible personal property and taxable labor and services been reported; (2) Has the cost of all business equipment and supplies that were purchased without tax, either from out-of-state vendors or for resale, been reported; (3) Were deductions properly claimed; (4) Were

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local taxes properly allocated; (5) Was the correct rate of tax used; and (6) Was tax properly applied to sales and use of tangible personal property.

BOE auditors attempt to verify certain information reported on the return and may issue a *notice of determination* (or a *deficiency determination* for taxpayers who fail to file a return) to the taxpayer for amounts that appear to be due.

A taxpayer who disagrees with the BOE's determination of amounts owed may file an appeal, called a *petition for redetermination*. All of the taxpayer's contentions, including substantiating evidence in the form of books, records, or other documentation are addressed with the auditor or appropriate BOE staff. If BOE staff confirm the legitimacy of the assessment, a *notice of redetermination* is issued, unless the taxpayer requests either a Board hearing or appeals conference, which provides taxpayers with another opportunity to present material in support of their position. At the appeals conference or hearing, taxpayers may present facts and material in support of their position. After that hearing, the appeals section representative will prepare a *decision and recommendation* (D&R), containing an analysis, conclusion, and recommendation for the case. If the taxpayer disagrees with the D&R, the taxpayer may request a hearing before the Board Members (Board).

A Board hearing is typically not granted until all other opportunities for resolution are exhausted, so that every attempt to resolve cases at the lowest possible level is afforded. In the event of a final adverse Board decision, the taxpayer may then pay the amount of the determination and file a claim for refund. If the Board denies the refund claim, then the taxpayer may bring action against the state in Superior Court. In litigation, as with appeals, there is a rebuttable presumption that the government's action was correct.

The taxpayer's forum for appealing a FTB or BOE action on a protest is with the Members of the Board of Equalization (Board). The five elected Board Members serve as the appellate body in final actions of the FTB and BOE. In the independent review by the Board, there is a rebuttable presumption that the FTB or BOE action was correct. Hence, taxpayers have the burden of proving that the action was incorrect and establishing the merits of their claims by a preponderance of the evidence. In the event of a final adverse Board decision, the taxpayer may bring action against the state in Superior Court. In litigation, as with appeals, there is a rebuttable presumption that the government's action was correct.

Background:

Dick Bros., Inc. v. Comm. CA3 (1953) 205 F2d 6 established that the taxpayer has the burden of going forward with evidence to rebut the presumption. Placing the burden of proof on the taxpayer means that the taxpayer must affirmatively provide information and/or documentation to prove that he or she is entitled to, for example, a claimed deduction. In other words, there is no presumption that he would not have claimed a deduction to which he was not entitled.

The BOE administers 27 tax and fee programs. In sales and use tax matters, the burden of proof is on the taxpayer, not only to demonstrate that a BOE determination is *This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*

incorrect, but to produce evidence from which a proper tax determination can be made. The taxpayer cannot simply assert that the BOE made an error and shift the burden to the state to prove otherwise. See *Paine v. State Board of Equalization* (1982) 137 CA3d 438.

H.R. 2676 (Archer, et al.), which is known as the “Internal Revenue Service Restructuring and Reform Act of 1998,” was signed into law in 1998. This bill contains several provisions under the title Taxpayer Protection and Rights. One such provision would shift the burden of proof in court proceedings from the taxpayer to the IRS under the same conditions that would apply under AB 572.

Proposed Law:

With respect to the provisions of this bill that would impact the BOE, this bill would provide that the BOE, not the taxpayer, shall have the burden of proof in any court proceeding with respect to any factual issue relevant to ascertaining the tax liability of a taxpayer, if the taxpayer (1) introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer, and (2) has maintained all necessary records with respect to the issue and has cooperated with reasonable requests by the Board for witnesses, information, documents, meeting, and interviews. The bill would also require the Board to have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed.

Similar Bills:

Several bills were introduced during the 1997-98 Legislative Session that addressed the burden of proof issue, but none were sent to the Governor. Those bills, authors, and the Board positions included: AB 1631 (Sweeney, et al.) – Neutral, point out problems, SB 1425 (Hurt, et al.) – Neutral, and SB 1478 (Rainey) – Neutral, point out problems.

COMMENTS:

1. Sponsor and Purpose of the Bill: This bill is sponsored by the author in an effort to, with respect to the BOE provisions, conform to the burden of proof provisions of the IRS Restructure and Reform Act.
2. This bill is generally consistent with the IRS Restructuring and Reform Act of 1998. The requirement in this bill regarding taxpayer maintenance of records is slightly different than the IRS Act requirement. Also, the IRS Act specifies that the burden of proof shall apply to court proceedings arising in connection with examinations commencing after the enactment date, or in cases where there is no examination, the burden of proof shift would apply to court proceedings arising in connection with taxable periods or events beginning or occurring after the enactment date. This would allow tax agencies, beginning with the enactment date, to maintain the detailed records regarding “cooperating taxpayer,” and other evidence not ordinarily kept but necessary to sustain the burden of proof requirement proposed by this bill.

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3. Shifting the burden of proof under these provisions should not pose an unreasonable obstruction to the Board in determining the correct gross receipts. The Board's auditing and litigation practices ordinarily produce sufficient evidence to sustain the burden of proof, especially when the Board is asserting additional gross receipts. The Board does not generally rely solely upon the taxpayer's failure of proof to sustain the asserted liability, even though the taxpayer has the burden of supporting any claimed exempt transactions.
4. This bill would place a greater emphasis and scrutiny on the audit process. Under current law, determinations of the court are strictly *de novo*, meaning that what occurs during the audit process is immaterial, and the taxpayer is required to prove the proper liability in court. Under this bill, exceptions to the burden of proof rule concentrate on communications between the BOE and the taxpayer during an audit, such as what requests for information were made by BOE, and whether the taxpayer is cooperating. Therefore, the audit working papers must carefully document taxpayers' cooperation and substantiation, and the BOE's requests for information.
5. The applicability of penalties is generally easily demonstrated. If a tax return is delinquent or not filed, the taxpayer's file should reflect the date the return was received or should have been received. If a taxpayer submits an explanation of reasonable cause, if applicable for that penalty, this response should be documented in the file. If the case advanced to a court proceeding, the BOE would have appropriate documentation to substantiate any applicable penalty.
6. Taxpayers may interpret the burden of proof shift more broadly than it actually is. It is imperative that taxpayers understand that the changes imposed by this bill would not minimize their responsibility to properly determine and document their tax liabilities. The BOE would necessarily engage in some form of a public relations plan to inform taxpayers of their responsibilities under the new law.

COST ESTIMATE:

This bill would result in somewhat stricter record-keeping requirements during audit procedures (See Comment 4), and the development of informational materials, etc., to inform taxpayers of the new law (See Comment 6). These costs could be absorbed within the existing budget.

REVENUE ESTIMATE:

This bill should not impact the state's revenues.

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